

ANALYSIS OF ORIGINAL BILL

Author: Lockyer Analyst: Gloria McConnell Bill Number: SB 247

Related Bills: See Legislative History Telephone: 845-4336 Amended Date: 03/10/97

Attorney: Geoff Way

Sponsor
:

SUBJECT: All Child Support Obligations 90 Days Delinquent to Franchise Tax Board
for Collection

SUMMARY

Under this bill, all child support obligations that the district attorney is responsible for enforcing and that are 90 days delinquent would be referred to Franchise Tax Board (FTB) for collection as though they were delinquent personal income taxes.

In addition, certain persons under federal law currently required to file an information return reporting personal services for which \$600 or more was paid, would be required to report certain information about those services and payments to Employment Development Department (EDD) within the earlier of 30 days of entering into the personal service contract or paying the \$600. For purposes of this analysis, persons performing personal services (service-providers) for a trade or business for which \$600 or more is paid will be termed "independent contractors."

Staff's analysis of the child support collection provision and independent contractor registry provisions is separately provided, beginning on page 2 and page 7, respectively.

EFFECTIVE DATE

This bill would be effective and operative on January 1, 1998.

LEGISLATIVE HISTORY

AB 3589 (St. 92, Ch. 1223); SB 1423 (Stats. 1992, Ch. 850); AB 65 (St. 93, Ch. 878); AB 923 (St. 94, Ch. 906); SB 319 (Solis, 1995/96); AB 573 (Kuehl, 1997); AB 1395 (Escutia, 1997).

POSITION

Pending.

CHILD SUPPORT COLLECTION PROVISION

DEPARTMENTS THAT MAY BE AFFECTED:

<u>STATE MANDATE</u>		<u>GOVERNOR'S APPOINTMENT</u>	
Department Director Position: ____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ____ PENDING	Agency Secretary Position: ____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO _____	GOVERNOR'S OFFICE USE Position Approved ____ Position Disapproved ____ Position Noted ____	
Department Director	Agency Secretary	Date	By: _____ Date: _____

PROGRAM HISTORY/BACKGROUND

FTB primarily administers the Personal Income Tax Law (PITL) and Bank and Corporation Tax Law (BCTL). When a final personal income tax liability is delinquent and is not voluntarily paid, FTB takes administrative collection action that does not require prior judicial action.

Federal law requires each state to have a single agency responsible for enforcing child support, but permits delegation of specific tasks to local levels. The Department of Social Services (DSS) is designated as the California state agency. By state law, the county DAs are delegated responsibility for establishing paternity and enforcing child support, which includes collecting current payments and delinquencies. Prior to commencing the child support enforcement process, judicial action is required. However, once a court order is obtained, DAs can serve by mail an earnings assignment order for current support and may include any amounts that have accrued as of the date of the order. These earnings assignment orders are for payments of a fixed dollar amount. Once an ordered amount becomes delinquent, DAs are required to search for assets of the obligor and take collection actions as necessary to collect the delinquent account. The actions include wage garnishments through an administrative notice of earnings assignment.

In 1993 (Speier, AB 3589; Stats. 92, Ch. 1223), FTB began collecting delinquent child support through a pilot project in which DAs in six counties could voluntarily refer their delinquent child support accounts to FTB for collection as though they were delinquent personal income taxes. In 1995, the program was expanded to include voluntary referral from all counties (Speier, AB 923; Stats. 94, Ch. 906). While for purposes of this collection program, an account is considered delinquent if it is 30 days or more past due, typically, the average account referred to FTB for collection is 31 months past due. However, a significant number of referred accounts are five years or more delinquent.

Currently, 35 counties are participating in FTB's voluntary child support collection program. Of the remaining 23 counties, two counties will be participating shortly, and for 14 counties, participation is awaiting implementation of DSS' Statewide Automated Child Support System (SACSS). Seven counties have elected not to participate in FTB's child support collection program. Attached is the participation schedule as of January 31, 1997.

Once a child support payment becomes delinquent, both DAs and FTB can take a variety of collection actions, some of which are as follows:

- With respect to garnishing wages, the FTB may issue an administrative withholding order (without court action) and garnish up to 50% of the obligor's disposable earnings. The DAs may also garnish up to 50% of the obligor's disposable earnings; however, they must first obtain a court order through a judicial writ proceeding. The DAs may also utilize an administrative withholding order; however, in these cases they are limited to garnishing an amount not to exceed the greater of 3% of the delinquency or \$50.
- With respect to tangible personal property, both DAs and the FTB can administratively issue warrants to seize and sell vehicles, boats and airplanes owned by the obligor. With respect to bank accounts, the FTB may levy on these accounts through administrative action; however, the

DAs must first obtain a court order through a judicial writ proceeding prior to levying on the accounts.

FTB's child support collection program is funded through two components: federal reimbursements and county incentive payments, both of which are distributed by DSS. Federal guidelines allow states to recover 66% of their administrative costs through reimbursement. The county incentive payments, which are made up of state and federal funds, are determined by a three part structure, which includes compliance and performance standards and a base rate of 6% of any support collections distributed, including FTB's collections. To compensate FTB for its child support collection program, counties participating in the program share up to 50% of their base rate incentive for the amounts FTB collects, but not to exceed FTB's actual departmental costs. The base incentive structure, from which FTB is partially funded, sunsets June 30, 1998. The future as to funding is unknown.

With the two funding components, FTB's child support collection program receives 66% of its costs through federal reimbursement and the remaining 34% from county base incentives.

In the event a child support wage assignment/garnishment is served on an employer who is honoring a wage garnishment for taxes or other debts, the employer, under the Wage Garnishment Law, must give priority to the child support assignment/garnishment. If an FTB garnishment for taxes (earnings withholding order for up to 25% of disposable earnings) is being honored at the time the employer receives a child support assignment/garnishment, the child support assignment/garnishment becomes superior and the earnings withholding order for taxes (EWOT) is set aside. The EWOT is deferred until the child support wage assignment/garnishment is satisfied or one year after employment terminates, whichever is the earlier. In the case of other types of levies/orders to withhold (e.g., bank accounts), the first levy/order to withhold received has withholding priority.

Under current tax law, FTB's child support collection activities must not interfere with FTB's responsibility to administer the PITL. A collection priority is established under tax law whereby if more than one debt is being collected by FTB, FTB is required to apply amounts "being collected" first against personal income taxes and the balance, if any, to child support obligations.

To avoid the conflicting requirements between the withholding priority for employees and FTB's collection priority, FTB staff currently rejects any child support delinquency that is referred where a debtor has an outstanding personal income tax liability. The delinquency is returned to the DA for the DA to collect. While it is estimated that approximately 10% to 12% of the cases that FTB receives are returned to the DAs because the debtor has an outstanding personal income tax liability, detail as to the dollar amount of the competing debts and other statistical data relative to the collection thereof are not readily available.

Under FTB's current guidelines for referring cases to FTB, a case cannot be referred if it does not include the obligee's social security number (SSN). The criterion with respect to the SSN was established because FTB is focusing implementation on an automated collection process, which requires an SSN to match asset information.

For fiscal year 1995-96, the average delinquency referred to FTB for collection was 31 months past due and \$9,500. For fiscal year 1995-96, DAs received approximately \$50 million in FTB-collected delinquent child support, of which:

- 58% (\$28.9 million) was collected on behalf of Aid to Families with Dependent Children (AFDC) to offset AFDC grant expenditures from the federal, state and county governments;
- 41% (\$20.7 million) on behalf of non-AFDC families. These collections go directly to the families; and
- 1% (\$.4 million) on behalf of foster care costs, which offset foster care expenditures from the federal, state and county governments.

Since the program began 38 months ago (through January 31, 1997), FTB has collected over \$131 million in delinquent child support.

The federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 provides for welfare reform that, in part, sets new limits and eligibility restrictions for those receiving aid and pressures states to develop child support income streams to get support in the hands of families quickly. It also changes the federal incentive funding and reimbursement structure, which, as previously discussed, California uses to fund portions of its child support enforcement programs, including FTB's child support collection program. The impact on FTB's funding source as a result of these federal changes is not yet known.

SPECIFIC FINDINGS

Under current law, the DAs are allowed to refer to FTB for collection child support delinquencies that are at least 30 days delinquent. Under current practice, once the DA refers the delinquency to FTB, FTB sends the obligor a demand for payment. The demand provides that FTB will commence collection action unless payment in full is made within 10 days. Because currently referral of delinquencies is voluntary, the DAs and FTB have latitude in determining which accounts will be accepted by FTB for collection.

Under this bill, DAs would be required to refer to FTB for collection all their child support delinquencies that are 90 days past due. In order to accommodate the workload, FTB may phase in the accounts. Once the delinquency is referred to FTB, FTB would be required to send the obligor notice of the amount due at least 20 days prior to taking collection action. The DAs would continue to be responsible for managing, maintaining and referring to FTB the delinquent accounts and FTB would be responsible for taking collection action thereon.

Policy Considerations

- One goal of federal welfare reform is to accelerate the collection of delinquent child support and get it into the hands of the families quickly. This bill would result in accelerating the collection of child support, as discussed below under Collection Estimate and Discussion.
- Currently, FTB's collections offset AFDC grant expenditures from the federal, state and county governments. Thus, the collections result in some General Fund recoupment. To the extent welfare reform results in changes in the structure of aid to families and reduces the General Fund expenditure for these programs, FTB's future child support collection program may be of less direct financial benefit to state government.

However, it can be argued that society as a whole benefits when families receive financial assistance through child support collections.

- With this bill, FTB could not continue to reject child support cases because of a competing tax debt, which would lead to the concern discussed under Implementation Considerations. In any event, there should be a single withholding and collection priority for California, without regard to whether the competing tax and child support debts are being collected by FTB.

Some may argue that the collection of a child support delinquency always should be superior to taxes because it benefits families. However, it could be prudent to give taxes priority, especially in the case of a competing small tax debt that could be expeditiously satisfied and a large child support delinquency that would take years to satisfy.

If the bill were amended to change FTB's collection priority to give child support delinquencies priority over taxes, it could have an impact on the General Fund of an unknown amount.

Implementation Considerations

According to DSS information from June 1994:

- there were a total of approximately 900,000 cases with child support orders,
- the annual growth rate is 14%, and
- over half of the orders (approximately 56%) are paid sporadically or never paid (delinquencies).

FTB staff assumes that for fiscal year 1997-98 the percentage of delinquencies would not materially differ from the percentage of delinquencies in June 1994. Taking into consideration the 14% growth factor, this assumption yields an approximate total of 800,000 delinquent accounts, of which 500,000 would be referred to FTB by the end of 1997 under the existing child support collection program. Therefore, under this bill an additional 300,000 delinquencies would be phased in, of which 250,000 would be phased in between January 1, 1998, and June 30, 1998, maximizing the capacity of FTB's existing child support collection system. The 50,000 remaining accounts would be phased in during early 1998-99. For fiscal year 1998-99, it is estimated that there will be an additional 150,000 delinquencies, with an additional 150,000 for 1999-00.

Staff recognizes that FTB would be required to receive and collect accounts for those obligors that also may have outstanding personal income tax liabilities or that do not contain SSNs:

- In the event of competing debts, staff is researching whether under current law FTB could satisfy the statutory mandate of not disrupting tax collections, comply with the collection priority, and apply the collection in the same priority as the withholding. For example, it is unclear whether FTB could issue an earnings withholding order or bank order to withhold for the child support delinquency if the debtor is under a payment arrangement for the tax delinquencies. In those cases, if the debtor's ability to meet the terms of his/her payment arrangement for taxes were not affected by FTB's child support collection action, it

is unclear whether the resulting collections could be applied to child support.

In this situation, the personal income tax delinquency is being paid voluntarily by the debtor rather than being actively collected by FTB through collection actions. However, in cases where no payment arrangement exists or the collection of child support would disrupt the ability to make the tax payments, if FTB were to issue competing earnings withholding orders (one for taxes and one for child support) it is unclear under current law how the collected funds should be applied against the outstanding debts.

Additionally, because the earnings withholding cap for child support is 25% greater than that for personal income taxes and the collection priority does not address how FTB is to apply that greater amount, FTB lacks clear authority to either apply the entire amount being collected (50% of disposable earnings) to taxes or split the amount, half to taxes and the remainder to child support. Preliminary staff discussions also indicate that to accommodate the splitting of a single payment between taxes and child support would add complexities to FTB's accounting and existing computer system.

- For those accounts without SSNs, FTB has recently developed an automated matching process to determine the SSN of vehicle owners who have delinquent vehicle registrations, which FTB is responsible for collecting. The matching process automatically searches various records that contain social security numbers and are available to FTB. FTB staff presumes a similar process could be used to obtain the SSN of obligors of delinquent child support. Using the experience of the vehicle registration collection program, staff anticipates that the SSN could be determined in the majority of those child support delinquency cases that would be referred without SSNs.

FISCAL IMPACT

Departmental Costs

Under the assumptions described under Implementation, this provision would increase department costs as follows:

Departmental Costs Impact SB 247 Fiscal Year (In Millions)		
1997-98	1998-99	1999-00
\$1.3	\$3.9	\$3.6

The cost include:

1997-98 -- Software and system staff to accommodate the additional workload. For this limited period (January 1, 1998, to June 30, 1998), there would be a small increase in collection and payment processing staff. Total increase of approximately 15 personnel years (PY).

1998-99 - Increase in collection, payment processing and support staff. Also, a new file server and processors to maintain the additional workload. Total increase of approximately 39 PYs for a total of 54.

1999-00 -- On-going system, collection and support staff. Total increase of approximately 1 PY for a cumulative three-year total of 55.

Detail as to the costs are available upon request.

Collection Estimate

Based on the discussion below, the amount of collections from this provision is estimated to be as follows:

Estimated Collections Impact AB 247		
Fiscal Year		
(In Millions)		
1997-8	1998-9	1999-0
\$15	\$60	\$60

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Collection Estimate Discussion

To estimate the number of accounts that would be referred to FTB under this bill, staff used the information and assumptions described under Implementation. To determine the average collections, FTB staff assumed that collections under this bill would be similar to those under FTB's existing child support collection program. This estimate does not include the potential collections of delinquencies that otherwise would have been rejected by FTB due to a competing income tax obligations.

INDEPENDENT CONTRACTOR REGISTRY PROVISION

PROGRAM HISTORY/BACKGROUND

Employers are required on a quarterly basis to report to EDD information on its employees, which includes the employee's SSN. EDD's employer/employee information is available to FTB shortly after the end of each quarter. In addition, SB 1423 (Stats. 1992, Ch. 850) requires employers, in general, to report the employee's name and SSN to EDD within 30 days of the hiring, rehiring or return to work of an employee. The new-employee information originally was to be used only for child support enforcement and collecting unemployment benefit overpayments, but its use has been expanded to allow for personal income tax enforcement. By regulations, the new-employee reporting requirement is limited to 17 industries that historically employ people on a temporary or short-term basis. The New-Employee Registry law was enacted to help collection actions against those individuals who were able to avoid collection because the quarterly return information was received too late to be used as an effective collection resource. EDD may impose a penalty against employers that fail to report new employees as required.

Under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, by October 1, 1997, all states are required to operate a state directory of new employees, whereby all employers must report all new employees not later than 20 days after employment, or twice a month if reporting electronically.

For both income tax and child support collection purposes, if a tax debt or child support delinquency is unpaid, the employee information file is searched. If an employee is matched to a tax debtor or child support obligor, an Earnings Withholding Order is issued against any earnings of the debtor or obligor.

Under Section 6041A of the Internal Revenue Code (IRC), persons in a trade or business who pay \$600 or more for personal services (service-recipients) to an independent contractor are required to file an information return (1099MISC) reporting the nonemployee compensation to the Internal Revenue Service (IRS) at the end of the calendar year.

If a service recipient misclassifies an individual as an independent contractor instead of an employee, the individual would be reported under Section 6041A. Because the individual is actually an employee, this reporting is not actually required under Section 6041A, but is done only because of the misclassification. In addition, under federal law, for employment tax purposes, if an individual is misclassified as an independent contractor, the individual may not be reclassified by the service recipient for that period of misclassification. For this misclassified period, the payments that otherwise would have been considered wages are treated as though they are payments due an independent contractor. Furthermore, there may be instances where an individual is an independent contractor for federal purposes, but an employee under California law (statutory employee). Because of misclassifications and statutory employees, a service recipient may file a federal Form 1099MISC (Section 6041A), but for California purposes would be required to report the individual's payments to EDD as employee wages.

Under current law, if a person (which may include personal service corporations) is an independent contractor and is paid \$600 or more, the payment of those services should be reported either to EDD as wages or IRS as nonemployee compensation on Form 1099MISC.

Whether the compensation is wages or payments for personal services, the compensation is considered "earnings." As such, 50% of the individual's disposable earnings are subject to garnishment for purposes of collecting child support delinquencies.

SPECIFIC FINDINGS

Under Section 6041A of the Internal Revenue Code (IRC), persons in a trade or business (service-recipients) that pay \$600 or more for personal services to an independent contractor are required to file an information return (1099MISC) with the IRS by February 28, following the close of the calendar year. The 1099MISC contains the following information:

- the name, address, and federal identification number of the person filing the information return,
- the name, address and identification number of the independent contractor (SSN in the case of an individual), and
- the aggregate amount of the payments made to that person.

For California purposes, service recipients are required to send a copy of their federal 1099MISC to FTB at the same time it is required to be filed with the IRS. If a service recipient has more than 250 independent contractors, the 1099MISC copy must be filed with FTB on magnetic media, which is generally available for FTB to access by May or June. If the service recipient has less than 250

independent contractors, it may elect to file a combined federal/state 1099MISC or file a paper information return. In the case of a combined or paper information return, IRS shares the information contained on the information return with FTB, and this information is generally available for FTB access by November.

Under this bill, service-recipients who are required to file an independent contractor information return under Section 6041A would report to EDD the same information required on the 1099MISC described above, plus the following additional information:

- the date of the contract or, if no contract, the date that payment first exceeded \$600, and
- the total dollar amount of the contract, if any, and the contract expiration date.

The information would be reported the earlier of 30 days after entering into the personal service contract or, if no contract, first paying more than \$600.

Under current law, the New-Employee Registry information is retained by EDD for no more than six months after the calendar quarter.

Under this bill, the ICR information would be retained by EDD for no more than six months after the contract expiration date or the date the payments first exceed \$600.

Policy Consideration

Whether collecting delinquent tax or child support, FTB generally experiences the same collection difficulties for individuals who perform personal services under short-term or temporary contracts. It is unclear why the ICR information should not be used for tax enforcement purposes.

Implementation Considerations

FTB staff anticipates it would use the Independent Contractor Registry (ICR) for child support collection in the same form and manner that it uses EDD's New-Employee Registry. If the ICR information is matched to a child support delinquency, FTB would issue an administrative Earnings Withholding Order.

Staff has determined that using the six-month threshold to measure the 180-day retention period may result in the ICR information being expunged prematurely. Under this provision, for example, if a 12-month contract is executed March 1st, and \$700 is paid to the obligor during March, the ICR information would be expunged in September, five months before the contract expires and presumably the final contractual payment made to the obligor the following February. Using this example, if the child support delinquency were to exist in August, before the ICR information is expunged, an earnings withholding order would be issued to the service-recipient to reach any payments that were paid to the obligor between August and the remainder of the contract. However, if the child support becomes delinquent in September, after the information is expunged, FTB would not know of the existence of the service-recipient until the 1099 information is received, which could be as late as the following October, well after the expiration of the contract and final payment. To eliminate this unreported period and maximize the use of the ICR information, the ICR information should be

retained until the end-of-year 1099MISC information is available to FTB. The attached Amendment 4 would extend the retention period.

Technical Considerations

The following are staff's suggested technical considerations. The attached Amendments 1 through 3 make the following suggested changes:

- "Service-providers" can include personal service corporations. However, for purposes of child support collections only individuals can be obligors; therefore, the reporting requirements likewise should be limited to individuals only.
- If service-recipients file 1099s though not required to do so, they should be required to file with the registry, unless the individual is reported as an employee for California purposes.

FISCAL IMPACT

Departmental Costs

Currently, EDD charges FTB for its use of the New-Employee Registry for child support purposes. Assuming the costs for the Independent Contractor Registry were approximately the same, the costs per fiscal year could be in the \$10,000 range and would be included in the child support collection program's annual budget.

Collection Estimate

Estimated Collections Impact AB 247 Information from Service Recipients Fiscal Year (In Millions)		
1997-8	1998-9	1999-0
\$1	\$5	\$8

These analyses do not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Collection Estimate

This estimate is based on the results of FTB's current child support collections program and 1099MISC information available to FTB reported under IRC Section 6041A (non-employee compensation). In addition, the following data and assumptions were used:

- FTB would use the ICR in a manner similar to the new employee registry and issue similar withholding orders.
- Employment Development Department (EDD) would process the service-recipient information within 30 days of receipt in a format that FTB can use to match records submitted by FTB.

- By the third year the maximum reporting compliance rate would be achieved, which would be two-thirds (22% the first year, 44% the second year).
- Adjustments were made in the first year to exclude pre-existing contracts and to allow for implementation lags.
- The average contract period is six months.
- The average collection amounts for independent contractors were based on the total child support collections through Earnings Withholding Orders divided by total returns with reported salaries and wages, increased by 50% to reflect potentially larger incomes of independent contractors.

This estimate does not take into consideration increased child support obligations for current or delinquent support that would be collected by DAS as a result of the reporting required by this bill. It only includes increased collections by FTB for delinquent child support.

County Participation Schedule

Participating Counties		Participation in Process		Awaiting SACSS	Not Participating
Name	Date	Name	Date	Name	Name
Alameda	10/95	Kern	In Process	Amador	Alpine
Butte	02/96	Riverside	In Process	Del Norte	Colusa
Calaveras	01/96			Glenn	Imperial
Contra Costa	04/96			Inyo	Modoc
El Dorado	02/95			Madera	San Diego
Fresno	12/93			Mariposa	Tuolumne
Humboldt	11/95			Mendocino	Yuba
Kings	08/95			Mono	
Lake	01/96			Plumas	
Lassen	08/95			San Luis Obispo	
Los Angeles	12/93			Shasta	
Marin	03/95			Sutter	
Merced	02/95			Trinity	
Monterey	03/95			Yolo	
Napa	01/96				
Nevada	12/93				
Orange	06/95				
Placer	10/95				
Sacramento	07/95				
San Benito	04/96				
San Bernardino	03/95				
San Francisco	01/96				
San Joaquin	06/95				
San Mateo	03/95				
Santa Barbara	06/96				
Santa Clara	12/93				
Santa Cruz	09/96				
Sierra	07/96				
Siskiyou	08/96				
Solano	12/93				
Sonoma	08/95				
Stanislaus	10/95				
Tehama	07/95				
Tulare	04/95				
Ventura	12/93				

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO SB 247
As Amended March 10, 1997

AMENDMENT 1

On page 12, line 40, after "who" insert:
makes or

AMENDMENT 2

On page 13, line 20, strike out "a person" and insert:
an individual who is not an employee of the service-recipient for California
purposes and

AMENDMENT 3

On page 13, line 22, after "performed" insert:
for that service-recipient

AMENDMENT 4

On page 14, strike out line 5 through 7, inclusive, and insert:
(c) until November 1 following the tax year in which the contract is executed, or
if no contract, November 1 following the tax year in which the payments first
exceeded six